IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT.

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No. 9234.

J. E. RILEY INVESTMENT COMPANY,
PETITIONER,

VS.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

ON PETITION TO REVIEW DECISION
OF THE
UNITED STATES BOARD OF TAX APPEALS.

BRIEF FOR PETITIONER.

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Opinion Below.

The memorandum findings of fact and opinion of the Board of Tax Appeals are not officially reported but appear in the record at page 19.

Jurisdiction.

This appeal involves deficiencies in income and excess profits taxes of $453.50 and $164.91, respectively, for the calendar year 1934 and is taken from the order of the Board of Tax Appeals entered May 11, 1939. Petitioner claims it overpaid its taxes for 1934 in the amount of $2,598.21. The case is brought to this Court by petition for review filed June 15, 1939, pursuant to Sections 1141 and 1142 of the Internal Revenue Code.

Question Presented.

Is the petitioner, a gold mining corporation, entitled to percentage depletion under Section 114 (b) (4) of the Revenue Act of 1934? Or is it to be denied depletion for 1934 and all succeeding years because, on account of its isolated location in the interior of Alaska, it had no knowledge of the enactment of the provision allowing percentage depletion and, therefore, could not and did not "elect" to take the percentage depletion allowance in its original 1934 return, although such allowance was claimed in an amended return?

Statute Involved.

Section 23, Revenue Act of 1934:

"Deductions from Gross Income. In computing net income there shall be allowed as deductions: * * * (m) Depletion.—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion * * *, according to the peculiar conditions in each case; * * *."

Revenue Act of 1934, Section 114 (b) (4):

"Percentage Depletion for Coal and Metal Mines and Sulphur.—The allowance for depletion under section 23 (m) shall be, in the case of coal mines, 5 per centum, in the case of metal mines, 15 per centum, and, in the case of sulphur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, * * *. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property. A taxpayer making his first return under this title in respect of a property shall state whether he elects to have the depletion allowance for such property for the taxable year for which the return is made computed with or without regard to percentage depletion, and the depletion allowance in respect of such property for such year shall be computed according to the election thus made. If the taxpayer fails to make such statement in the return, the depletion allowance for such property for such year shall be computed without reference to percentage depletion. The method, determined as above, of computing the depletion allowance shall be applied in the case of the property for all taxable years in which it is in the hands of such taxpayer * * *.

Statement of the Facts.

The facts were fully and fairly found by the Board as follows (R. 19):

"Petitioner is a corporation organized under the laws of Nevada, with its principal office and place of business at Flat, Alaska. Its business is the mining of gold.

"Flat is located in a remote part of Alaska on the 62nd parallel of latitude and 158th meridian of longitude. During the season of navigation, the usual means of travel to Flat from Seward, the seaport, is from Seward, by railroad, to Nenana on the Yukon River, a distance of 415 miles, then by water via the Yukon River to Holy Cross, a distance of over 700 miles, and thence via a tributary of the Yukon to Flat, a distance of 420 miles. When navigation is not open, travel to and from Flat is either by plane or on foot. It requires about two weeks to go over the 400-mile trail on foot from Flat to Anchorage, which is the nearest town.

"The uncertainty and slowness of the winter mail service invariably resulted in current tax return forms reaching Flat too late for timely execution and filing. In order to avoid delinquency, it was the custom of petitioner's officers to use old return forms; consequently petitioner's original return for 1934 was filed on a 1933 form which had been mailed to petitioner by the Collector of Internal Revenue at Tacoma, Washington. In the winter of 1934, mail came to Flat part way by plane and part way by dog team. In order to be sure of filing the 1934 return on time, an officer of petitioner executed it on January 2, 1935, using the 1933 form, as stated. It reached Tacoma on January 29, but mail from Flat sometimes took two months in arriving at Tacoma.

"When petitioner's first 1934 return was filled out, its officers did not know of the statutory provisions allowing percentage depletion, but did know that unless the law had been changed, petitioner was not entitled to depletion, as it had no basis for cost depletion. The Collector, in sending the forms, had not advised the petitioner with respect to statutory depletion, and all the knowledge then available to it on this score was contained in Instruction No. 23 attached to the 1933 form, which reads as follows:

> "23. Depletion.—If a deduction is claimed on account of depletion, secure from the collector Form D (minerals), Form E (coal), Form F (miscellaneous non-metals), Form O (oil and gas), or Form T (timber), fill in and file with return. If complete valuation data have been filed with Questionnaire in previous years, then file with this return information

necessary to bring your depletion schedule up to date, setting forth in full statement of all transactions bearing on deductions or additions to value of physical assets with explanation of how depletion deduction for the taxable year has been determined. See Sections 23 (1) and 114 of the Revenue Act of 1932.

"Petitioner's officer read the instructions before executing the return for 1934.

"Petitioner's officers first actually learned of the statutory depletion provisions in August, 1935, when a revenue agent visited Flat and advised that petitioner was entitled to percentage depletion for both 1933 and 1934. This agent prepared reports to that effect, as a result of which a refund was paid for 1933, but not for 1934; as to the latter year, the respondent ruled that petitioner had failed to claim percentage depletion in its original return and hence was not entitled to claim it subsequently.

"If petitioner's officers had known of the 1934 statutory provisions, they would have elected to take percentage depletion.

"As soon as petitioner's officers were advised that percentage depletion had been disallowed, they filed both an amended return claiming such depletion in the amount of $13,600.57, and a claim for refund.

"Petitioner's gross receipts from gold mining for the year 1934 were $99,711.56 and it has paid a tax for that year in the amount of $4,684."

In its opinion, the Board states (R. 25):

"Had petitioner's officers known of the election provided by the 1934 Act, they would have exercised it. Since petitioner had no basis for cost depletion, their 'election', in the premises, would really have been as between claiming a deduction and not claiming it, for if they did not deduct by a use of the percentage method, they could not deduct at all. Not knowing of this statutory right, their collective feeling at the time they executed the 1934 return was that they were not entitled to depletion of any kind."

Summary of Argument.

The statute here involved has been construed by the Circuit Court of Appeals for the Fourth Circuit in *C. H. Mead Coal Company v. Commissioner* in an opinion which correctly states the law. The said opinion is printed in the appendix of this brief.

Section 23 of the Revenue Act of 1934 is specific in providing that metal miners *shall* be allowed a reasonable deduction for depletion. Section 114 (b) (4) merely prescribes the manner in which the reasonable allowance for depletion is to be computed. The Congressional purpose in providing percentage depletion was to broaden the allowance and remove administrative difficulties. This is shown by the legislative history of the depletion provision.

"Election" is dependent upon the opportunity to choose between two or more conflicting courses and, in the absence of such opportunity to choose, there can be no "election." Consequently, the first return form filed in this case did not constitute an election.

In addition to the Court construction in the Mead case of the statute here involved, the Board of Tax Appeals and the Courts have had no difficulty in construing similar statutory language to permit amended returns.

Amended returns are recognized and have been uniformly construed as being amendments or supplements to the original return. Consequently, the "first" return means an amended first return, so an election made in an amended first return is an election made in the "first" return.

ARGUMENT.

The section of the statute here involved has been passed upon by the Circuit Court of Appeals for the Fourth Circuit in *C. H. Mead Coal Company v. Commissioner of Internal Revenue,* decided August 28, 1939. The case is not yet officially reported, but appears at ¶5.600 of the Prentice-Hall 1939 Federal Tax Service. It is reprinted in full in the appendix of this brief at page 23.

The facts in the Mead case are that the taxpayer, when filing its return for 1933, did not claim depletion because it had a loss. However, it attached a statement to its return stating it elected to take percentage depletion for all subsequent years in the case of certain listed properties. In its return for 1934 the taxpayer, acting on the erroneous advice of counsel, did not take depletion. Some time later, as the result of a conversation with a Revenue Agent, the taxpayer decided it had the right to take such depletion. Accordingly, on February 6, 1936, it filed an amended return and claim for refund. The Commissioner disallowed the depletion deduction on the ground the taxpayer had not "elected" to take it in its first return filed under section 114 (b) (4) of the Revenue Act of 1934. The Board of Tax Appeals sustained the Commissioner. 38 B. T. A. 1163.

In reversing the Board of Tax Appeals, the Fourth Circuit states:

"In using the words 'first return' Congress evidently intended to include a completed first return, or a first return as properly amended and did not intend to limit the taxpayer's right of election to the first form filed. Any other construction would, in fairness to the taxpayer, be too narrow and restricted. A first return is no less a first return because amended, provided the amendment be timely and is made to correct a mistake, made without any intent on the part of the taxpayer to take any undue advantage as to its tax payments, and without any bad faith. A different construction would, as said in the case of *Glenn v. Oertel Co.,* 97 Fed. (2) 495, permit the government to lay a tax upon the taxpayer's errors rather than its income."

Later the Court states:

"* * * we are forced to the conclusion that in all fairness, and certainly fairness is to be expected from a government in dealing with its taxpayers, the amendment to the return should have been allowed. In rejecting the amendment, the Commissioner was in error."

Still later in the opinion the Court states:

"If an amendment made to correct a mistake, presented within a reasonable time, is rejected through a narrow and harsh construction of the law, to the detriment of the taxpayer, such rejection is arbitrary and unjust. It certainly is not the duty of the Commissioner to deprive a taxpayer of any rights justly due him."

The Court goes further and says:

"We agree with the contention made on behalf of the petitioner that the depletion provisions of the Revenue

Acts of 1932 and 1934 are liberalizing, rather than limiting, provisions and that Congress intended to allow depletion deductions by one of the two methods, and intended to give taxpayers a right to elect whichever method they preferred. The decision of the Board in this case deprives the petitioner of that right."

It would seem that little can be added to the reasoning of the Fourth Circuit However, with the belief that some further thoughts might be helpful to this Court the following is submitted:

Statute Says Depletion Shall Be Allowed.

The statute is specific in providing that depletion *shall* be allowed to metal miners. The exact language is:

Section 23, Revenue Act of 1934:

"In computing net income there *shall* be allowed as deductions: * * * (m) Depletion.—In the case of mines, oil and gas wells, other natural deposits, and timber, a *reasonable allowance* for depletion * * * according to the peculiar conditions in each case * * *" (Italics supplied.)

After having enacted the provision requiring "a reasonable allowance for depletion" which is inevitable and inescapable, Congress in Section 114 (b) (4) merely prescribes the manner in which the reasonable allowance for depletion is to be computed. The purpose of Congress in providing percentage depletion was to broaden the allowance and to remove administrative difficulties. This purpose should be furthered and not nullified, as has been done by the Board of Tax Appeals decision which denied a deduction for depletion to this taxpayer not only for 1934, but for all succeeding years.

Legislative History of Percentage Depletion.

Beginning with the Act of October 3, 1913, the various Revenue Act have provided for a deduction for depletion where income is derived from the extraction of natural deposits or timber.

The Revenue Act of 1918 (Sec. 234 (a) (9)) inserted the language, which still remains in the statute, providing for the deduction: "In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion * * * according to the peculiar conditions in each case * * *". The 1918 Act also provided for "discovery" depletion where the fair market value of the property is materially disproportionate to the cost.

The administration of the depletion section, particularly the "discovery" depletion section was particularly difficult. In theory, the owner of a natural resource was supposed to own a certain number of depletable units, some of which were consumed each year, and he was allowed to deduct from income the cost or discovery valuation basis of the units consumed. In practice great difficulties were encountered in determining basic valuations, depletable reserves, depletion rates and other facts.

In other words, the administration of the depletion section resolved itself into a battle between valuation and mining engineers and other experts representing the taxpayer on the one hand and those representing the Commissioner on the other. In an effort to eliminate this confusion, Congress in the 1926 Act, decided to eliminate discovery depletion in the case of oil and gas wells and substitute therefor percentage depletion. This step was taken "in the interest of simplicity and certainty in administration''. (Seidman's Legislative History of Federal Income Tax Laws, p. 584.)

The percentage depletion method worked so well in the case of oil and gas wells that percentage depletion was adopted and discovery depletion abandoned in the case of coal, metal and sulphur mines by Section 114 (b) (4) of the 1932 Act. The said act did not require that a taxpayer make an election to take percentage depletion for 1933 but did require that he state in his 1933 return if he desired percentage depletion for all succeeding years, and that the depletion allowance should be computed for all succeeding taxable years in accordance with the election therein made.

The 1934 Act in Sec. 114 (b) (4) reenacted the percentage depletion provisions of the 1932 Act with reference to coal, metal and sulphur mines, but gave a new opportunity of election, stating:

> ''A taxpayer making his first return under this title in respect of a property shall state whether he elects to have the depletion allowance for such property for the taxable year for which the return is made computed with or without regard to percentage depletion, and the depletion allowance in respect of such property for such year shall be computed according to the election thus made. If the taxpayer fails to make such statement in the return, the depletion allowance for such property for such year shall be computed without reference to percentage depletion. The method, determined as above, of computing the depletion allowance shall be applied in the case of the property for all taxable years in which it is in the hands of such taxpayer, * * *''

The Senate and House Reports and the Congressional discussion all specifically state that the ''election'' provision was written "to avoid administrative complexity" (Seidman's Legislative History of Federal Income Tax Laws, page 353). That could mean only one thing—the prevention of the taxpayer from taking percentage depletion in one year, jumping to cost depletion the next, and vice versa. In the case at bar, the Board states (R. 25):

> "Had petitioner's officers known of the election provided by the 1934 Act, they would have exercised it. Since petitioner had no basis for cost depletion, their 'election', in the premises, would really have been as between claiming a deduction and not claiming it, for if they did not deduct by a use of the percentage method, they could not deduct at all."

Surely, in the light of these facts, this Court is not going to deny the "reasonable allowance for depletion" which Sec. 23 of the statute says *shall* be allowed.

It is obvious from an examination of the legislative history of the depletion provisions that the tendency and intention of Congress has been to broaden and liberalize the allowance. If the Board of Tax Appeals is affirmed in this case, the Congressional intent will be disregarded and the taxpayer not given any allowance for depletion.

The Fourth Circuit in the Mead case (reprinted in the appendix hereof) states:

> "We agree with the contention made on behalf of the petitioner that the depletion provisions of the Revenue Acts of 1932 and 1934 are liberalizing, rather than limiting, provisions and that Congress intended to allow depletion deductions by one of the two methods, and intended to give taxpayers a right to elect whichever method they preferred. The decision of the Board in this case deprives the petitioner of that right."

Election is dependent upon the opportunity to choose between two or more conflicting courses and, in the absence of such opportunity to choose, there can be no "election."

The Board, in the case at bar, specifically found that this taxpayer had no knowledge of the provision allowing percentage depletion. The Collector, in sending the forms, had not advised the taxpayer of the said provision (R. 20, 21).

This Court will judicially notice that Regulations 86, promulgated under the 1934 Act, were not approved by the Secretary of the Treasury until February 11, 1935 (See official print of regulations). After approval, the regulations were printed and were not released to the public until March 2, 1935. If the taxpayer had known of the provision, the only choice to be made was whether to claim percentage depletion, with a resulting deduction in taxes of $3,216.62, or not to claim the deduction and pay the higher tax (R. 25).

It is fundamental that no person can be held to have made an "election" unless advised of the two or more opportunities open to him and he selects one. The rule is stated by Mr. Justice Holmes in *Bierce v. Hutchins,* 205 U. S. 340, 346, as:

> "Election is simply what its name imports; a choice, shown by an overt act, between two inconsistent rights, either of which may be asserted at the will of the chooser alone."

Chairman Arundell of the Board of Tax Appeals in his dissenting opinion in *Dorothy Glenn Coal Co.,* 38 B. T. A.

#148, which involves a construction of the same statute here involved, states:

> "Election presupposes the existence of the right of a choice between alternatives. *Allis v. Hall*, 56 Atl. 637; *Standard Oil Co. v. Hawkins*, 74 Fed. 395; *McIntosh v. Wilkinson*, 36 F. (2d) 807; *Tide Water Oil Co.*, 29 B. T. A. 1208; 48 Harvard Law Review 1281. To say that one is put to his election when he has no choice is to give him nothing more than a 'Hobson's choice'. The Acts of 1932 and 1934 both use the terms 'elect' and 'election'. These words become meaningless if applied so as to require an election where there is no right of choice."

The foregoing clearly shows that "elect" has a judicially settled meaning. Consequently, it must be presumed it was used in that sense by Congress. In *U. S. v. Merriam,* 263 U. S. 179, 4 A. F. T. R. 3673, the Supreme Court states (p. 187):

> "The word * * * having the judicially settled meaning which we have stated, we must presume it was used in that sense by Congress." (Citing authorities.)

In addition, the provision here involved is remedial by being intended to give depletion to miners who otherwise would not get it. The rule of construction is:

> "The statute is a remedial one and should be construed liberally to carry out the wise and salutary purposes of its enactment." *Stewart v. Kahn,* 11 Wall. (78 U. S.) 493, 504.

The Courts and the Board of Tax Appeals have construed similar statutory language.

In addition to the Mead case, previously referred to, and which is printed in the appendix hereof, the Courts and the Board have had no difficulty with questions similar to the one here involved.

Ralph Leslie Raymond, 34 B. T. A. 1171, (acquiesced in by the Commissioner in G. C. M. 19727, ¶5204-B, Prentice-Hall Federal Tax Service) involved an interpretation of Sec. 131 of the 1932 Act, which provides that taxpayers will be allowed credit for foreign taxes paid "if the taxpayer specifies on his return his desire to have the benefits of this section". In that case the taxpayer filed a non-taxable return and did not claim credit for Canadian taxes paid. Upon audit, a loss was disallowed and the Commissioner disallowed the credit under Sec. 131, because the taxpayer had failed to signify on his return that he desired the benefits of this section. The Board in its opinion reviewed the cases on election and properly holds that the taxpayer should prevail.

A similar result was reached in *Connor v. U. S.,* 19 F. Supp. 97, 19 A. F. T. R. 683, wherein the Court, construing the foreign tax paid credit section, held "the law should not be interpreted to require the impossible", stating, "the petitioner was not called upon to make any election under Section 131 (a) as the word 'election' signifies a choice between two or more methods."

Amended returns are recognized and have been uniformly construed as being amendments or supplements to the original return.

In the case at bar, it should be remembered that the first return for 1934 reached the Collector at Tacoma, January 29, 1935 (R. 20). In August, 1935, a Revenue Agent visited Flat and advised petitioner it was entitled to percentage depletion for both 1933 and 1934, and prepared reports to that effect (R. 21). The Commissioner overruled the Agent and held that, as petitioner had not claimed percentage depletion for 1934, it could not be allowed (R. 22). Immediately thereafter petitioner filed an amended return and claim for refund claiming percentage depletion (R. 21).

We submit that where a Revenue Agent schooled in the law, but located in far-off Alaska, is ignorant of the requirement of "election", it is putting an unreasonable interpretation on the law to say that the petitioner made an "election" and cannot be permitted to amend its return and claim the deduction for depletion the statute says *shall* be allowed.

The law is that while the statute does not provide for amended returns, such returns have always been accepted and recognized as being amendments or supplements to the original return.

As long ago as O. D. 113, C. B. 1919, p. 234, the Commissioner ruled:

> "A corporation may submit amended returns for previous years when through wrong accounting practice capital charges have been made to income. * * *"

Mim. 2207, C. B. 1919, p. 221, allows amended returns in cases where corporations took unauthorized deductions.

Articles 36 and 111 of Regulations 45, promulgated under the Revenue Act of 1918, provided for amended returns to show correct expenses or charges against income.

I. T. 1450, C. B. Dec. 1922, p. 200, held that an amended return and claim for refund could be filed by a corporation which had not taken a deduction for depreciation in its 1920 return.

It will be noted that the rulings quoted permitted amended returns to show correct items of income or deductions, which is what is being contended for in this case.

Courts have uniformly held that amended returns may be filed to show correct items of income and deductions. This is true even where the first return constituted an "election". In *Lucas v. Sterling Oil & Gas Co.,* 62 F. (2d) 951, 12 A. F. T. R. 90, the taxpayer, under Treasury Regulations, had the option of charging certain expenditures in connection with oil and gas wells to capital or treating them as operating expense. An election, once made, was to control for all subsequent years. Taxpayer's original return for 1919 capitalized such expenditures. After other facts had been ascertained the taxpayer, February 10, 1921, filed an amended return which treated the expenditures as operating expenses. On neither return was a tax due. The 1920 return again treated such expenditures as operating expenses. Upon audit of the 1920 return the Commissioner ruled the expenditures for that year must be capitalized as the taxpayer had so elected in the 1919 return. The Court states (p. 951):

> "There is no statutory authority for amended returns, but it is well known that the Treasury Department, both in practice and by Regulation (Articles 36 and 111

of Regulations 45) has been liberal in authorizing and accepting such returns.''

At page 952, the Court continues, stating that after learning that certain profits for 1919 should have been reported for that year the taxpayer filed an amended return:

> ''This seems to us to constitute the first instance of a mature and deliberate choice by the appellee, based upon knowledge of all the material facts * * * and, in view of the effect of an election upon future returns, we do not think that such election should be held to be effected, unless based upon knowledge of this kind as indicative of a final and deliberate choice. * * * and where the initial return is filed upon incomplete knowledge of the material facts, and before the filing of a return for the subsequent year, the taxpayer ascertains other pertinent facts and files an amended return disclosing them, it seems to us that the initial return may properly be regarded as tentative in its nature, and as not constituting an election. In such case, the taxpayer should be permitted to do what he had the right to do in the first instance.''

It seems to us that the only distinction between the Sterling case and the case at bar is that in one there was a lack of knowledge of fact and, in the other, a lack of knowledge of law.

We next come to the Supreme Court's announcement i *Zellerbach Paper Co. v. Helvering,* 293 U. S. 172, 14 A. F T. R. 688, wherein the Court was called upon to decide th effect of an amended return on the statute of limitation Mr. Justice Cardozo states (p. 180):

> ''From this administrative history, the inference : compelling that a second return, reporting an add

tional tax is an amendment or supplement to a return already upon the files, and being effective by relation does not toll a limitation which has once begun to run."

The only possible conclusion to be reached from the foregoing is that an amended return must be considered in the same light as the original return. Consequently, in the case at bar, an "election" was made in the "first" return filed.

This is the construction adopted by the Fourth Circuit in the Mead case:

> "In using the words 'first return', Congress evidently intended to include a completed first return, or a first return as properly amended and did not intend to limit the taxpayer's right of election to the first form filed * * *. A first return is no less a first return because amended * * *."

It is to be assumed that the Government will rely upon *Pacific National Co. v. Welch*, 91 Fed. (2d) 590, 19 A. F. T. R. 1148, affirmed 304 U. S. 191, 20 A. F. T. R. 1248. That case involved a situation where the taxpayer reported the sale of lots as completed transactions in 1928. In 1931 it filed a different kind of return, *i. e.,* one which computed the profit on the entirely different installment method, and also filed a claim for refund.

This Court, in its opinion, points out (p. 593):

> "The taxpayer reported the sales as deferred payment sales, just as they were reflected upon its books. It indicated by its original income tax return for the year 1928 that it chose to report the sales as completed transactions, rather than as installment contracts. By

> filing its return on that basis, it made a choice or election and it may not, at a later date, when it appears to its advantage to do so, *change the method of making its report.*" (Italics supplied.)

In affirming this Court, the Supreme Court states (p. 194):

> "Change from one *method* to the other, as petitioner seeks, would require recomputation and readjustment of tax liability for subsequent years and impose burdensome uncertainties upon the administration of the revenue laws * * *. There is nothing to suggest that Congress intended to permit a taxpayer, after expiration of the time within which return is to be made, to have his tax liability computed and settled according to some other *method.*" (Italics supplied.)

We agree that a taxpayer cannot by an amended return change the *method* of reporting income. Typical of such cases are where a taxpayer reports on a cash basis and attempts to file an amended return on the accrual basis; a husband and wife file a joint return and later attempt to file separate returns, or where affiliated corporations file consolidated or separate returns and, later, attempt to change the method.

As previously pointed out, however, the laws always has been that the erroneous reporting of items of income or deductions can be corrected by amended returns, and such amended returns are considered supplements to, or amendatory of the original returns.

In the Mead case the Fourth Circuit states:

> "In *Pacific National Co. v. Welch,* 304 U. S. 191, the Supreme Court held that where a taxpayer deliberately elected to report its profits from realty sales upon a completed transaction basis, the taxpayer was bound by the election once made. There was in that case no question of mistake or inadvertence on the part of the taxpayer * * *."

The Government will probably also cite the "capital stock tax" cases.[1] In those cases, it should be remembered that the statute, (Sec. 701, Revenue Act of 1934) provides for a tax on the adjusted declared value of the capital stock of corporations. Subdivision (f) of Section 701 provides that for the first year ending June 30, 1934, "the adjusted declared value shall be the value, as declared by the corporation in its first return under this section *(which declaration of value cannot be amended),* * * *" (Italics supplied).

The section in question is part of the same 1934 Act involved in the case at bar. It was enacted in the light of the known interpretation of the taxing acts permitting amendments to returns. If the Congress, which enacted the capital stock tax law, meant to prohibit the amendment of the returns concerned with the section involved in the case at bar, it would have done, as it did in the case of the capital stock tax,—specifically prohibited amended returns. The only inference to be drawn from its failure to do so, is that it expected the depletion section, which deals with deductions, to be treated as deduction sections have been treated in the past.

1. Haggar Co. v. Commissioner, 104 F. (2d) 24.
Scaife & Sons Co. v. Driscoll, 94 F. (2d) 664, 20 A. F. T. R. 978.
Chicago Telephone Supply Co. v. U. S., 23 F. Supp. 471, 21 A. F. T. R. 462.
Blake & Kendall Co. v. Commissioner, ¶5.478 Prentice-Hall Tax Service.
Rosoff Tunnel Corp. v. Higgins, ¶5.131 Prentice-Hall Tax Service.

Conclusion.

For the reasons stated, the decision of the Board of Tax Appeals should be reversed.

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September, 1939.

APPENDIX.

UNITED STATES CIRCUIT COURT OF APPEALS, FOURTH CIRCUIT.

C. H. MEAD COAL COMPANY,
v.
COMMISSIONER OF INTERNAL REVENUE.

Before PARKER and NORTHCOTT, *Circuit Judges,* and H. H. WATKINS, *District Judge:*

NORTHCOTT, *Circuit Judge:*

This is a petition to review a decision of the United States Board of Tax Appeals involving a deficiency in income taxes of the petitioner, C. H. Mead Coal Company, a West Virginia corporation, for the year 1934 in the amount of $1,475.16. 38 B. T. A. 1163.

After the Commissioner determined a deficiency the taxpayer applied to the Board for a redetermination. After a hearing the Board made findings of fact and rendered an opinion upholding the action of the Commissioner, two members of the Board dissenting. On December 30, 1938, a decision was entered in accordance with the opinion of the majority of the Board.

There is no dispute as to the facts and as found by the Board they are as follows:

> "Petitioner is a West Virginia corporation, with its office in Beckley, West Virginia, and is engaged in the business of mining and selling coal. It filed its income tax return for 1933 on March 15, 1934, with the collector

of internal revenue at Parkersburg, West Virginia. A net loss of $88,098.94 was reported but no claim for a depletion deduction was made. Attached to the return was the following statement signed by J. P. Nowlin as treasurer for the petitioner:

'This Tax-payer elects to have a depletion allowance for succeeding taxable years, computed with reference to percentage depletion in the case of the following properties:

Western Pocahontas Corporation Property (2 tracts)

Thompson-Davis property (1 tract)

Piney Coking Coal Land Company (2 tracts)

This tax-payer elects to have depletion computed without reference to percentage depletion in the case of the following property:

Stone Coal Land Company Tract.

No percentage depletion deducted for 1933 because this tax-payer has no net income for this year.'

Petitioner filed its income tax return for 1934 on March 15, 1935. The return showed net taxable income in the amount of $66,276.89 and a tax in the amount of $9,113.07. No depletion deduction was claimed. Neither did the return contain a statement showing any election to have a depletion allowance in respect of any of its properties computed with or without regard to percentage depletion for the taxable year or subsequent years. Petitioner's officers discussed the matter of filing a notice of election similar to that filed with its 1933 return, but, because of advice of counsel to the effect that it had nothing to deplete and was accordingly entitled to no deduction therefor, it claimed no depletion deduction on its 1934 return and filed no statement of election to take or to compute depletion on the percentage basis.

In January 1936, as the result of a conversation between its officers and an internal revenue agent, petitioner concluded that the advice of its counsel in respect of its right to take a depletion deduction was erroneous and that it should have claimed depletion for 1934 on the percentage basis. On February 6 following petitioner filed an amended return for 1934 with the collector of internal revenue at Huntington, West Virginia. In addition to the schedules attached to the 1934 return when filed on March 15, 1935, the amended return filed on February 6, 1936, carried a depletion schedule which reflected a claimed depletion allowance computed on the percentage basis in the amount of $33,138.44. At the foot of this schedule the following statement appears:

> Depletion allowance is computed on the percentage basis in accordance with our election previously made and stated on prior return.
>
> Through inadvertence no depletion allowance was deducted from income upon our original 1934 return. To correct that error this amended return for 1934 is filed, together with claim for refund of tax overpaid in consequence of our failure to deduct proper depletion allowance.

This respondent has refused to accept the amended return for 1934 filed by the petitioner on February 6, 1936, or the statements contained therein as a proper election under section 114 (b) (4) of the Revenue Act of 1934, to take depletion on the percentage basis.

> The parties have agreed that for 1934 petitioner is not entitled to a depletion deduction computed on the unit basis, and further that if it is entitled to a depletion deduction computed on the percentage basis the amount of the deduction is $15,632.09."

The only question presented for our consideration is whether the petitioner is entitled to percentage depletion for the year 1934.

The pertinent statutes are:

Sec. 23 (m) Revenue Act of 1934.

Sec. 114 (b) (4) Revenue Act of 1932.

Sec. 114 (b) (4) Revenue Act of 1934.

The contention on behalf of the petitioner is first, tha the election of percentage depletion made in its tax retur for the year 1933 held good for "all succeeding taxabl years" and therefore entitled it to percentage depletio for the year 1934 and, second, that if another election wa required by the Revenue Act of 1934, in making its amende return for the year 1934, which amendment the Commi sioner should have allowed, it had complied with the r quirement.

It is clear that if the petitioner has made the electi required by the Act of 1934, what it did in its return f the year 1933 is immaterial. We will therefore first co sider whether the Act of 1934 has been complied with the taxpayer. We are of the opinion that it has.

Appendix.

Section 114 (b) (4) of the Revenue Act of 1934 reads as follows:

> "* * *. A taxpayer making his first return under this title in respect of a property shall state whether he elects to have the depletion allowance for such property for the taxable year for which the return is made computed with or without regard to percentage depletion, and the depletion allowance in respect of such property for such year shall be computed according to the election thus made. If the taxpayer fails to make such statement in the return, the depletion allowance for such property for such year shall be computed without reference to percentage depletion. * * *."

In using the words "first return" Congress evidently intended to include a completed first return or a first return as properly amended and did not intend to limit the taxpayer's right of election to the first form filed. Any other construction would, in fairness to the taxpayer, be too narrow and restricted. A first return is no less a first return because amended, provided the amendment be timely and is made to correct a mistake, made without any intent on the part of the taxpayer to take any undue advantage as to its tax payments, and without any bad faith. A different construction would, as said in the case of *Glenn v. Oertel Co.*, 97 Fed. (2) 495, permit the government to lay a tax upon the taxpayer's errors rather than its income. In that case the court discussed what constituted a "first return" and said:

> "We think that the correct view, which accords with the principle that 'in construing tax laws all doubt must be decided in favor of the taxpayer' (*Gould v. Gould,*

245 U. S. 151, 38 S. Ct. 53, 62 L. Ed. 211) is, that the incorrect, invalid return springing from an honest mistake would not support any fair levy or assessment and that the Congress did not intend to prohibit its correction within the permitted period; that 'the taxpayer should be permitted to do what he had the right to do in the first instance' (*Lucas v. Sterling Oil & Gas Co.*, 6 Cir., 62 F. 2d 951, 952); and that the corrected return of September 1 be adjudged the 'first return under this section' as distinguished from returns of subsequent years which were to be based thereon. * * *. This neither penalizes appellee nor takes away from appellant any substantial right. It places appellee upon an equal footing with all similar taxpayers who file a single corrected return within the permissible limit. * * *."

Here the taxpayer, being badly advised, failed to claim depletion on a percentage basis in the first form of the return it made but immediately upon learning of its mistake, and before the time for filing its return for the next succeeding year, filed an amendment claiming the depletion to which it was admittedly entitled.

When we consider the fact that in its return for the year 1933 the taxpayer had elected to claim depreciation for succeeding taxable years as provided in the Revenue Act of 1932; that at the time of filing its initial return for the year 1934 it had no knowledge that its election to claim depreciation on a percentage basis was required to be repeated; that the printed form for the 1934 return contained no notice that a new election was required; and that by its amended return it endeavored to correct the mistake, stating that it had been made "through inadvertence", we are forced to the conclusion that in all fairness, and certainly fairness is to be expected from a government in dealing with its taxpayers, the amendment to the return should have been allowed. In rejecting the amendment the Commissioner was in error.

It is contended on behalf of the respondent that in failing to claim depletion on a percentage basis in its return first filed, the taxpayer had made an election and that the election so made may not later be rescinded by the filing of an amended return. We cannot agree with this contention.

The Board of Tax Appeals held in the case of *Raymond v. Commissioner,* 34 B. T. A. 1171, that the Commissioner was in error in not accepting an amended return offered by a taxpayer.

If an amendment made to correct a mistake, presented within a reasonable time, is rejected through a narrow and harsh construction of the law, to the detriment of the taxpayer, such rejection is arbitrary and unjust. It certainly is not the duty of the Commissioner to deprive a taxpayer of any rights justly due him.

> "This seems to us to constitute the first instance of a mature and deliberate choice by the appellee, based upon knowledge of all the material facts as disclosed by the closing of its books; and, in view of the effect of an election upon future returns, we do not think that such election should be held to be effected, unless based upon knowledge of this kind as indicative of a final and deliberate choice."
>
> *Lucas v. Sterling Oil & Gas Co.,* 62 F. (2d) 951.

"* * *. In view of the radical changes in the law, of which the petitioner had scant notice, if any, in fairness and justice to the taxpayer the returns should have been received and considered. Taxes are assessed on income and not on honest mistakes of the taxpayer. It was the duty of the Commissioner to do nothing arbitrary or unreasonable that would deprive petitioner of rights created by the new law and the regulations thereunder. It was a breach of discretion on the part of the Commissioner not to receive the amended return from 1925 under the circumstances disclosed."

Morrow, Becker & Ewing, Inc. v. Commissioner, 57 F. (2d) 1.

We agree with the contention made on behalf of the petitioner that the depletion provisions of the Revenue Act of 1932 and 1934 are liberalizing, rather than limiting, pro visions and that Congress intended to allow depletion de ductions by one of the two methods, and intended to giv taxpayers a right to elect whichever method they preferred The decision of the Board in this case deprives the petition er of that right.

As was said by the dissenting member of the Board:

"While there is no statutory authority for amende returns, 'it is well known that the Treasury Depar ment, both in practice and by regulation * * * ha been liberal in authorizing and accepting such returns *Lucas v. Sterling Oil & Gas Co.,* 62 Fed. (2d) 951. I that case the taxpayers had exercised an option, gran ed by regulation, of charging certain expenditures t capital. In February of the following year, after othe facts had been ascertained, it filed an amended return claiming the expenditures as operating expenses. The court held that under the facts there present 'the initial return may properly be regarded as tentative in its nature, and as not constituting an election. In such case the taxpayer should be permitted to do what he had the right to do in the first instance.' In *Morrow, Becker & Ewing, Inc. v. Commissioner,* 57 Fed. (2d) 1, the court recognized the lack of statutory authority for amended returns, but held that it was a breach of discretion for the Commissioner to refuse to accept an amended return wherein the taxpayer, greatly to its own benefit, sought to change from the installment basis to the deferred payment basis of reporting income. Cf. *F. Harold Johnston, Executor,* 33 B. T. A. 551. These cases establish the power in the Commissioner to accept amended returns under circumstances similar to those in the present case, particularly where the taxpayer acts with reasonable promptness to take advantage of a statutory privilege clearly granted. That is the situation here. Before the petitioner's return was due for the next taxable year it sought to secure the statutory privilege of securing percentage depletion. Under the facts here I think that the petitioner should be permitted to do what it had the right to do in the first instance, namely, choose percentage depletion.''

Cases relied upon to support respondent's contention that the amendment should not have been allowed are those in which a different statute is involved. In *Pacific National Co. v. Welch,* 304 U. S. 191, the Supreme Court held that where a taxpayer deliberately elected to report its profits from realty sales upon a completed transaction basis the taxpayer was bound by the election once made. There was in that case no question of mistake or inadventence on the part of the taxpayer and no question of a former election such as was made by the petitioner here in its return for the year 1933.

Other cases relied upon on behalf of the respondent* hold that amendments to a return were properly rejected. We are of the opinion that these cases are not controlling here.

In the class of cases known as the capital stock tax cases, also relied upon by the respondent, the statute under consideration expressly provides that the declaration of valuc made in the first return cannot be amended. In *Haggar Co v. Commissioner of Internal Revenue,* 104 F. (2d) 24, anc *William B. Scaife & Sons Co. v. Driscoll,* 94 F. (2d) 664, i was held that the express language of the statute precludec the amendment. A similar holding is found in the case o *Blake & Kendall Co. v. Commissioner,* 1 Cir., decided Jun 13, 1939.

Yet, as we have set out above, the *Oertel* case held tha even where the statute expressly prohibited an amendme it should be allowed under the circumstances of that cas and in *Philadelphia Brewing Co. v. United States,* decid by the Court of Claims May 29, 1939, the *Oertel* case is a proved and followed.

* Buttolph v. Commissioner, 29 F. (2d) 695; Alameda Inv. Co., et al. v. McLaug lin, 33 F. (2) 120; Rose v. Grant, et al., 39 F. (2d) 340; Lucas v. St. Louis N tional Baseball Club, 42 F. (2d) 984; certiorari denied, 282 U. S. 883; Du Power Co. v. Commissioner, 44 F. (2d) 543; Radiant Glass Company v. Burr 54 F. (2d) 718; Champlin v. Commissioner, 78 F. (2d) 905.

Appendix.

In none of the decisions we have found do the facts make as strong a case for the allowance of an amendment to a tax return, so that the taxpayer may be treated fairly and equitably, as do the facts in the instant case.

Our conclusion that the petitioner has complied with the requirements of the Revenue Act of 1934 makes it unnecessary for us to discuss the effect of the election made by it in its return for the year 1933 for that and succeeding years.

Reversed.